

## Board self-assessments are here to stay—and for good reason!

Since the New York Stock Exchange (NYSE) required annual assessments for the boards and major committees of their listed companies in 2004, the number of boards engaging in a self-assessment process has dramatically increased. Today, boards of all types of companies—non-NYSE and even non-profits—have embraced the trend on a voluntary basis.

Studies suggest that the popularity of board assessments will continue to rise. In 2002, a survey conducted by *Corporate Board Member* magazine and PricewaterhouseCoopers found that only 33% of U.S. respondents said their boards performed formal assessments regularly. By 2005, that percentage had climbed to 84%.

The increase in board self-assessments over the last few years has not been confined to the U.S. A 2007 study by Heidrick and Struggles concluded that 100% of companies in Sweden, 88% in the U.K., and 70% in the Netherlands are conducting full board assessments on a regular basis.

More than ever, board self assessments have become an expectation of investors and non-governmental organizations (NGOs) whose organization's purpose is to influence corporate behavior for the better. For example, the Institutional Investor Services (ISS) now includes board and committee assessments as a factor in assessing and ranking a company's corporate governance practices, regardless of whether the company is listed on the NYSE or another exchange.

So how many companies are performing board assessments today in the U.S.? In a 2006 NACD survey, 88% of respondents said that their companies perform full board assessments annually, 90% perform committee assessments annually, and 72% perform individual Director assessments annually. Furthermore, 71% of the respondents served on public company boards of which half were large-cap companies. Only 48% of the respondents served on boards of companies that are listed on the NYSE.

For all practical purposes, board assessments are now the norm for companies wanting to demonstrate the pursuit of best practices in corporate governance.

### Why Assessments Matter

Boards today are under a microscope like never before. The traditional standards by which boards have governed under state law remain the same—the duty of care; the duty of loyalty; the evolving duty of disclosure and the business judgment rule—but the interpretation of their meanings is evolving. Given the increasing overlay of federal regulation directly related

to governance issues, the increasing pressure and influence of NGOs, the plaintiff's bar and the ever present reality of an allegedly mismanaged crisis appearing on the front page of *The Wall Street Journal*, what's a Director to do?

With the increased demand for corporate transparency, it would seem prudent for a board to be a bit more introspective into how it is discharging its duties and to revisit exactly what those duties are. One effective way to do this, as has been demonstrated by those who have pioneered the process over the last several years, is by way of a self-assessment.

During this process, boards should not look to fix anything that isn't broken, but rather take an honest look at and think through what they do, don't do and should be doing to best fulfill their oversight responsibilities. There are many good reasons for considering board assessments:

**Promote Good Governance:** Without a system of benchmarking and self-assessment, it's difficult to gauge whether your organization is utilizing corporate governance best practices. The awareness of "where you are now" will help you set your compass in order to get where you want to be and adopt governance practices that are right for your company. An effective self-assessment can identify gaps that may exist in the company's governance and also confirm the things you are doing correctly.

**Improve Performance:** As a board, you already insist on performance assessments for your management team. By implementing self-assessments, you can lead by example and send a strong message through the organization that you are holding yourselves, as well as management, accountable and that you expect continued improvement in performance from everyone. Assessments of individual board members, less common than assessments of the full board, also can be valuable. The first time they are used, they can be designed not primarily to evaluate, but to create job descriptions for individual board members to answer the question, "What do my peers expect of me?"

**Improve the Bottom Line:** Five years ago there was much more debate about whether good governance practices affect the bottom line. Today, however, experts have shown that stronger corporate governance ratings seem to dovetail with stronger financial results for a company. A recent Global Investor study by ISS showed that 70% of institutional investors describe the corporate governance of their portfolio companies as "important".

**Reduce Risk:** A structured assessment process provides a unique opportunity to evaluate the comfort level of the board with respect to the systems that are in place to monitor compliance with the increasing number of rules and regulations. The process can be designed to promote open dialog and/or confidential interviews to find out what the board is comfortable with and what they feel needs to be enhanced in the compliance area. Companies that engage in an assessment process are likely to create more effective compliance programs and oversight appropriate to their businesses that may limit their legal exposure.

**Strengthen Partnership Between Board and Management:** Self-assessments that are managed well promote both confidential one-on-one dialog and summary style open dialog about issues that might lie just beneath the surface, obstructing the relationship between the board and management. Once the issues are revealed and addressed, the communication between the board and management is strengthened.

**Help Set and Manage Expectations:** Assessments can be used to collectively define what board members expect from management with respect to information included in advance board packages, the format and number of the meetings, and the board's role in the development of business strategy and management development. They can be used to set the board's compass as to process and to refine its charter and the charter of each committee. The Directors are the overseers, but, like any organization, they need to adopt their own guiding principals about what their specific duties are and have an understanding of the tools they have at their disposal to measure job effectiveness.

Perhaps the best advice can be gleaned from Socrates, whose wisdom challenged us to "know thyself." The advice is most often taken as an admonition for individuals but it can be extended to boards. The assessment process can be an eye-opening experience for those looking to answer tough questions about how the board should govern in the best interests of the shareholders. It can help answer such questions as: Who are you? What do you stand for? What do you want to accomplish and how do you want to do it?

The great majority of Directors who have been through board assessments—even those that included individual assessments—say the process was valuable. According to a survey of 1,103 Directors titled *What Directors Think 2005* conducted by *Corporate Board Member* magazine and PricewaterhouseCoopers, 67% rated the full-board assessment process as either "very effective" or "effective," which is up from 37% only three years earlier.

## Who Should Champion the Process?

Including the right people in the self-assessment process is critical to a successful outcome. There must be a trusted leader (from inside or outside the company) who understands that the integrity of the process is paramount and that diplomacy and confidentiality are of utmost importance in order to get individual Directors to open up and share what is on their mind.

For that reason, many companies choose the lead independent Director or the non-executive chair of the board to lead the process. Often, the board leader has trustworthy lieutenants and others knowledgeable about the self-assessment process to act as advisors. The process may also be led by an independent committee, such as the Governance or Nominating committee.

The board leader can hire experts to prepare questionnaires and advise how to run the process. Trusted internal or external facilitators can conduct interviews or lead discussions while the board leader remains in charge to direct the overall process. Consultants or outside counsel may be used as advisors but the assessment must be championed and owned by the board itself—the responsibility cannot be abdicated.

The selected leader should make it a first priority of business to ensure that the board knows the reasons for the assessment, understands the implications, approves of the concept, and is prepared. During a meeting with the board, the leader should explain how the process will unfold, the confidential nature of the process, how the information gathered will be summarized and presented to the board, and how the information will be used to target opportunities for improvement.

## Planning for the Assessment

There are several important considerations when preparing to evaluate a board:

**Level of Detail:** Consider whether you want to evaluate specific issues (e.g. are Directors getting enough information and are they getting it in a timely manner?), broad topics (e.g. how can the board help the CEO develop corporate strategy better?), or a combination of the two.

**Focus Areas and Goals:** Identify the key areas of focus and goals for the assessment. For companies that already have committee charters and corporate governance guidelines in place, the board can use them to help identify the performance measures that will be used during the process. These documents can also be used to help

generate a questionnaire. Once the questionnaire is developed, it should be approved by the designated board leader and reviewed by company counsel.

**Whom Should You Evaluate:** Most boards start with an assessment process that focuses on the board's performance as a whole rather than the individual performance of its members. However, the process often provides an opportunity for a general discussion that can lead to a consensus about what the individual Directors *should* be doing—the beginnings of a Director job description. Once the consensus for individual performance has been reached, taking the step to include individual Director assessments is much easier because the Directors understand expectations.

**Type of Assessment:** Interviews, interactive dialog, quantitative surveys, or any combination of these may be used in a self-assessment. A survey of 798 respondents from public companies conducted by NACD entitled *2006 Public Company Governance Survey* found that 72.4% of the companies conduct Director assessments by questionnaire. Quantitative surveys tend to be easier to keep anonymous, provide flexibility, and allow for progress to be measured over time. Ad-hoc, loosely structured assessments, even though they will satisfy the minimum NYSE requirements, are not as likely to be as thorough and effective as a structured methodology. The combination of a survey and one-on-one interviews, followed by a general discussion of summary findings, seems to yield the best result.

**Confidentiality:** Most experts recommend that the board assessment process and individual answers to questionnaires be kept anonymous, especially if they involve peer assessments. Anonymity and discreet summaries allow Directors to be more candid with their feedback to a facilitator or the board leader, and will result in more accurate input on which the assessment and action plan can be based.

**Timing:** Consider how much time should be allotted on the self-assessment and ensure the scheduling fits in with the board's other priorities.

**Presenting the Findings:** Discuss with your board and company counsel how the results of the assessment will be presented—verbally or in written format? Consider developing rules of engagement for discussions with the board, while consulting company counsel regarding privilege issues.

**Legal Risk:** Consider the advice of counsel regarding the risk associated with any self-assessment process and their recommended steps to mitigate that risk.

## Technology for Conducting Assessments

Several technologies have recently emerged that can add significant value and ease to the assessment process. Online survey tools have existed for many years in the marketing world, but most of these tools do not meet the security needs of boards. Web-based board portals such as Thomson BoardLink™ offer a more secure alternative.

With a board portal survey tool, questionnaires can be quickly created by the company's internal facilitator (often the Corporate Secretary) under the direction of the board leader chosen to lead the process. The facilitator can customize the format of the survey and tailor the questions to suit the board's needs. When the facilitator is ready, he or she can print a paper survey for distribution or send a secure link to Directors enabling them to take the survey online. Web-based survey tools allow Directors to submit their responses and comments at their convenience from any location at any time. Featuring a higher level of security than traditional paper-based surveys, these tools utilize the same security strengths of a board portal, and survey responses cannot be viewed by anyone other than the intended respondents. Each user has a unique username and password which tells the application who they are and what they have permission to view. Application logic controls which users has access to create surveys, submit responses, and view results.

The board portal survey tool can also report when the survey has been completed by all of the Directors. The results of the survey can be quickly collected, analyzed, and compiled into a report with just a click of a button. The board portal survey tools also provide value by storing the survey questions for reuse or modification the following year.

Board portal survey tools allow a company to better comply with the recommendations of company counsel regarding privilege issues and the mitigation of potential legal risk of the survey results being the subject of a discovery request in future litigation. Document retention rules can be set up within the board portal to eliminate all of the survey responses by Directors when they are no longer needed.

## Follow Through for Change

Once the survey questionnaire has been completed by all respondents, the designated facilitator analyzes the results and determines areas of strength and weakness. The board leader then works with the facilitator to identify important performance gaps. The facilitator prepares a report on behalf of the board leader to be shared with the board members that includes a summary of the survey results and points of discussion. The summary results are presented objectively and in a way that preserves confidentiality.

Before the results go to the full board, the assessment facilitator and board leader should meet with the governance committee chair to discuss what was learned for each measured area, and identify any particular areas that may be ripe for improvement. For full board assessments, the board leader or governance committee chair will want to schedule a meeting with the board to engage in a candid and constructive dialogue on the results. For individual Director assessments, one-on-one sessions between the chairman of the governance committee and individual Directors may be useful.

The meeting of the board at which the board leader or the governance committee delivers the final report and recommendations is an opportunity to discuss issues constructively and develop an action plan. Some companies may want to use the results of the assessment to set the board's goals and process improvement objectives for the coming year. Experts suggest that formal board assessments should be done on a consistent, annual basis, helping to provide a basis for continual improvement.

## Conclusion

Board assessments are effective tools that promote good governance practices and it is clear that they are here to stay.

Through self-assessments, boards have an opportunity to lead by example and continually improve their effectiveness.

A self-assessment is a tool that can help a board improve the bottom line, strengthen communications between the board and management, improve compliance, reduce legal risks and set its own compass.

Web-based survey tools such as those provided in board portals can add value when conducting board assessments by making the process more efficient and secure.

---

*Nicole Bahlin is senior product manager at Thomson Financial. She can be reached at 617.856.2449 or [nicole.bahlin@thomson.com](mailto:nicole.bahlin@thomson.com).*

*Johnnie M. Jackson, Jr. is an attorney, board member, governance consultant and former Vice President, General Counsel and Secretary of Olin Corporation (NYSE: OLN). He can be reached at 203.353.9493 or [transcon@optonline.net](mailto:transcon@optonline.net).*

For more information, please contact Thomson Financial at 866.915.9891 or [tfcorporate@thomson.com](mailto:tfcorporate@thomson.com).